Agricultural Law Update

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The Ultimate Wisdom: The only alternative to perseverance is failure.

IRS revokes "PIK and roll" ruling

The IRS has changed its position with respect to the income tax consequences of the "PIK and roll" procedure whereby a cash basis farmer uses a payment in kind certificate or generic commodity certificate to redeem commodities pledged as security for a CCC loan. Revenue Ruling 87-17, issued in March, relied on USDA regulations in concluding that the use of generic commodity certificates to extinguish a CCC loan and reacquire the pledged commodities should be analyzed as a two-step procedure: (1) a sale of the pledged commodities in exchange for the discharge of the nonrecourse CCC loan which the commodities secured; (2) a separate and subsequent purchase of the pledged commodities with the use of the generic commodity certificates. Under this analysis, income was reportable on the first step to the extent the CCC loan discharged exceeded the farmer's basis in the pledged commodities. Income was not realized on the second step where the farmer's basis in the commodity certificates used to reacquire the pledged commodities was equal to the value of the reacquired commodities.

Revenue Ruling 87-103, issued in October, revokes Rev. Rul. 87-17. The later ruling indicates that the IRS had been informed by USDA officials after the first ruling that, despite its regulations, the use of commodity certificates to extinguish a CCC loan and reacquire pledged commodities was treated as a single, simultaneous transaction in which the loan was extinguished and the pledged commodities redeemed. Under this analysis, the commodity certificates were treated as received in *payment* of the loan, and income was realized on the extinguishment of the loan only to the extent it exceeded the farmer's basis in the commodity certificates given in payment.

The rulings dealt with the following facts: (1) *A*, a cash basis calendar year farmer, received a CCC loan of $12,000 in March of 1986, pledging grain worth

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Final rules on swampbuster and sodbuster program

On September 17, 1987, the final rule was published in the *Federal Register* to implement the sodbuster, conservation compliance, and swampbuster provisions of the 1985 Farm Bill (Pub. L. No. 99-198, provisions codified at 16 U.S.C. §§.3801-3823 (West Supp. 1987)). 52 Fed. Reg. 35193. The final rule replaces the interim rule published on June 27, 1986. The rule applies to crops planted after September 17, 1987 and to all determinations made after or pending on that date. The sodbuster provision in the 1985 Farm Bill denies USDA program benefits to a person who produces an agricultural commodity on highly erodible land without a conservation plan. Similarly, the swampbuster provision denies USDA program benefits to a person who produces an agricultural commodity on wetland converted after December 23, 1985, 16 U.S.C. §§ 3811, 3821 (West Supp. 1987).

In the final rule, many of the definitions in the interim rule have been revised. The definition of "highly erodible land" for purposes of the sodbuster provision has been amended to provide that "highly erodible land" is land that has an "erodibility index" of eight or more. 52 Fed. Reg. at 35201. "Erodibility index" is a "numerical value that expresses the *potential* erodibility of a soil in relation to its soil loss tolerance value *without consideration of applied conservation practices or management.*" *Id.* (emphasis added). Also the definition of "conservation plan" has been revised to be more specific about the contents of a plan, and the wetland definition has been revised to exclude lands in Alaska which have a predominance of permafrost soils. *Id.* at 35202.

Insofar as "wetland" is defined as land which supports "under normal circumstances" a prevalence of hydrophytic (aquatic) vegetation, "under normal circumstances" is defined to refer to "soil and hydrologic conditions that are normally present, without regard to whether the vegetation has been removed. *Id.* at 35207.

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$12,000 as security. *A*'s basis in the grain was zero, all expenses of producing it having been currently deducted. (2) In July of 1986, A received generic commodity certificates, pursuant to a government deficiency and diversion program, with a total face value of $10,000. The value of these certificates was reportable in income when received, and *A* took a corresponding $10,000 tax basis in them. (3) In December 1986, when the value of the pledged grain had fallen to $10,000, *A* terminated the loan and reacquired the pledged grain with the use of the commodity certificates.

The first ruling concluded, with respect to (3), that *A* was deemed to have sold the pledged grain, with a zero basis, in exchange for the discharge of the $12,000 nonrecourse CCC loan, resulting in $12,000 income. *A* then purchased the grain, worth $10,000, with the $10,000 face value commodity certificates. No gain was recognized on this repurchase since *A*'s basis in the certificates was also $10,000. *A* took a basis of $10,000 in the reacquired grain and recognized an additional $3,000 in income in 1987 when the grain was sold for $13,000.

Revenue Ruling 87-103 changed the result with respect to (3) by treating the use of the commodity certificates as a payment in extinguishment of the CCC loan. Under this view, only $2,000 in income resulted, the extent to which the $12,000 loan extinguished exceeded *A*'s $10,000 basis in the commodity certificates given in payment. Correspondingly, *A* kept a zero basis in the reacquired grain. When it was sold in 1987 for $13,000, that full amount was included in income in that year. Under Rev. Rul. 87-103, therefore, only $2,000 income resulted on termination of the loan in 1986 (as opposed to $12,000 in the earlier ruling) and $13,000 as reportable in 1987 on the subsequent sale of the grain (as opposed to only $3,000 in the earlier ruling). The later ruling thus allowed *A* to defer $10,000 in income from 1986 to 1987 where the sale of the reacquired commodity was similarly postponed. This deferral resulted, however, only where the farmer had not elected under IRC section 77 to include the proceeds of the CCC loan in income in the year received.

– Lonnie Beard

FINAL RULES ON SWAMPBUSTER AND SODBUSTER PROGRAM

CONTINUED FROM PAGE 1

Conservation compliance for highly erodible cropland in production or in USDA programs for any year from 1981-1985 is not required until the later of January 1, 1990 or the date two years after the SCS soil survey is completed. Revisions in the final regulation indicate that the soil survey that must be completed is that which applies only to the cropland portion of the tract or farm, not the plan for the entire farm. *Id.* at 35202.

In response to a statutory amendment on April 24, 1987 (Pub. L. No. 100-28), persons who had alfalfa in a crop rotation during each of the 1981 through 1985 crop years based on a conservation plan have an extension until June 1, 1988 to fully apply a conservation system to retain eligibility. *Id.* at 35202.

There is a statutory exemption for conversion of wetlands if conversion was "commenced" before December 23, 1985. 16 U.S.C. § 3822 (West Supp. 1987). A person seeking a determination of conversion commencing before December 23, 1985 must request the determination within one year following publication of the final rule, must demonstrate that the conversion has been actively pursued, and must complete the conversion by January 1, 1995. 52 Fed. Reg. 35203-04. The final rule revises the interim rule to clarify in great detail when conversion was "commenced."

Another revision clarifies that converted wetlands are presumed to have been converted by the person applying for benefits unless the person can show the conversionwas by an unrelated third party and there has been no involvement in a scheme or device to avoid compliance. 52 Fed. Reg. at 35203. If there was acquiescence in, approval of, or assistance to acts of the third party, the person applying for benefits is subject to the scheme or device restrictions and may lose eligibility. If, however, the conversion was in fact done by an unrelated third party, the person applying for benefits may continue to produce agricultural commodities on the converted wetland and retain eligibility so long as there are no further improvements to the drainage, or the SCS determines further improvement will have a minimal effect on wetland areas. *Id.* at 35202. Potholes, playas, and other wetlands flooded or ponded for periods of time will not be considered converted based on activities occurring prior to December 23, 1985, and further conversions may result in loss of eligibility unless determined to have a minimal effect on wetland values. *Id.* at 35208.

Further revisions include changes in the criteria for identifying highly erodible lands, new rules for exchange of certain crop acreage bases for crops that have a high residue base, clarifications on what constitutes an "artificial wetland," limitations on further alteration of converted wetlands which have been the subject of a minimal effects determination, and revisions in criteria for identifying converted wetlands. A full analysis of these revisions will appear in the "In Depth" section of a future issue of the *Agricultural Law Update*.

– Linda Malone

Jay's Law of Leadership:
Changing things is central to leadership, and changing them before anyone else is creativeness.

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Agriculture escapes Florida's sales and use tax on services

Florida passed a sales and use tax on services, effective July 1, 1987, that is being considered by other states as a model for those states' proposed taxes on the service industry. 1987 Fla. Laws 6, amended by 1987 Fla. Laws 72. Such a tax may be a valuable revenue raiser in the shift from an industrial to a service economy. Nonetheless, agriculture in Florida could have been devastated had it not been exempted from such taxation.

Florida exempted almost all agricultural services from its sales and use tax on services. Therefore, the Florida model provides a useful precedent for agriculture in those states considering a similar tax on services.

Twenty-four states have some form of sales tax on services. None, however, has promulgated a sales and use tax with a structure similar to Florida's or one that has as wide a scope. Conference with Wm. Townsend, Florida Department of Revenue General Counsel, September 24, 1987. Most sales tax laws on services enumerate the taxed services to the exclusion of all others; Florida's law taxes all services that are not expressly exempted in the law.

Many of the general provisions of the sales and use tax affect agriculture in Florida, although most agricultural services are expressly exempt from taxation. Most legal services are taxable. Note, however, that legal services related to bankruptcy are exempt. Financial services are exempt, with certain exceptions such as credit reporting services.

The original drafts of the sales and use tax exempted most agricultural services in accord with pre-existing exemptions for agricultural products. The Florida Department of Agriculture and the Farm Bureau convinced the legislature that agriculture is unlike a "professional service" because agriculture deals with the raw products and provides an essential commodity. Also, it was pointed out that the additional five percent tax would have irreparably damaged an already financially troubled sector, which is the state's second largest money producer. The legislature, however, initially provided for taxation of custom harvesting services.

The Florida Farm Bureau lobbied against the taxation of custom harvesting, stating that many smaller farmers could not afford to operate without the availability of custom harvesting. Further, it was argued that farmers, as price takers, are unlike most service providers, who can directly or indirectly pass on the tax. Telephone conference with Dennis Emerson, Florida Farm Bureau, Sept. 23, 1987. The final bill exempted almost all agricultural services, including custom harvesting.

The major agricultural exemptions in the Florida sales and use tax on services are outlined below.

Most agricultural services are exempted. These include soil preparation for planting; crop planting, cultivation and protection; harvesting; crop preparation for marketing services; licensed veterinarians' services; livestock services; animal specialty services relating to statutorily defined "agricultural products"; farm labor and management services; and general crop services from soil preparation through harvest.

Soil preparation for planting generally covers such services as plowing, land breaking, fertilizing, lime spreading, and weed control.

Crop planting, cultivation and protection includes such services as aerial dusting and spraying, disease control and insect control, pollinating, seeding crops, and irrigation.

Crop harvesting done primarily by machine is exempted. This includes machine harvesting of berries, cotton, fruits, vegetables, grain, peanuts, sugarcane, and tree nuts; chopping and silo filling; combining; hay mowing, raking, baling and chopping; and thrashing.

Crop preparation for marketing services includes such items as bean cleaning; cotton ginning; corn shelling; drying of corn and rice; hay; fruits and vegetables; grain cleaning; hay baling; sorting, grading and packing of vegetables and fruits; and packaging fresh or farm-dried fruits and vegetables. Fruit and vegetable precooling is exempt if not done in connection with transportation.

Veterinary services, including services by animal hospitals, are generally exempt, whether done for cattle, hogs, sheep, goats, poultry, horses, pets or other animals.

Exempt livestock services include artificial insemination; breeding of livestock; catching poultry with no hauling; cattle spraying; cleaning poultry coops; dairy herd improvement associations; milk testing; pedigree record services for livestock; vaccinations for livestock; and even showing of livestock.

Animal specialty services are exempt if they relate to "agricultural products," which are defined as including horticultural, viticultural, forestry, aquatic, dairy, livestock, poultry, bee, and any farm products. Such services as honey straining and vaccinating of pets and other animal specialties by one not a veterinarian are not exempt. Also veterinary services done by one who is not a veterinarian for cattle, hogs, sheep, goats and poultry are non-exempt.

Also exempt are farm labor and management services that supply labor for agricultural production or harvesting, or provide farm manmagement service, including crew leaders for farm labor on a contract basis; farm labor contractors; citrus grove management and maintenance, with or without crop services; farm management services; and vineyard management and maintenance, with or without crop services.

Those crop services not specificed by subsections (1), (2), and (3) of the agricultural exemption seem to fall under the "general crop services" exemption. That subsection defines such services as "a combination of services from soil preparation through harvest."

Services involved with transporting agricultural commodities as long as they retain their original identity are exempt, as are services involved with transporting phosphatic fertilizers. Note, however, that such related costs as leased cargo handling facilities or leasing fixed facilities are not exempted.

Services of a food or agricultural broker, who is defined as one who solicits, negotiates, or arranges for the transfer, transportation, purchase, or sale of agricultural commodities are exempt. This exemption applies to brokers of food or non-food agricultural commodities or products.

Forestry services and timber cutting, harvesting, estimating, and transportation are exempt. This exemption also applies to such collateral services as forest fire prevention and reforestation.

Warehousing of farm products is exempt. Exempt are warehousing and storage other than cold storage for bean cleaning and warehousing; bean elevators, except sales; cotton compresses and warehouses; grain elevators (used only for storage); potato cellars; tobacco warehousing and storage; and wool and mohair warehousing.

Services in refrigerated warehousing of perishable goods, including cheese warehouses, are exempt. Also exempt are incidental services for processing, preparing or packaging food for storage.

Persons in the business of tree trimming and removal generally are treated as performing a taxable service. Note, however, that such a service is exempt from sales or use tax if done as an agricultural or forestry service. Note that landscaping and horticultural services are taxable, although the Farm Bureau lobbied against that tax.

The emergency regulations implementing the Florida sales and use tax on services can be found at 12AER87-1 to -91.

Agricultural leaders in other states considering sales and use taxes may contact Mr. Doug Mann, Director of Legislative Affairs, Florida Farm Bureau, P.O. Box 730, Gainesville, FL 32602.

– Sid Ansbacher

The Uniform Capitalization Rules and cattle held for breeding and d

by Lonnie R. Beard

Traditional deductibility of expenses of raising livestock

Farmers on the cash method of accounting have traditionally been allowed to deduct "the purchase of feed and other costs connected with raising livestock." Treas. Reg. § 1.162-12(a). No distinction was made between livestock held for sale and livestock held for breeding and dairy purposes.

The Tax Reform Act of 1986 enacted IRC section 263A, which reverses this general rule. The new provision requires that both direct and indirect costs of plants and animals with a preproductive period of more than two years be capitalized until the productive stage of the plant or animal is reached. IRC § 263A(a), (d)(1)(A). However IRC sections 263A(d) (3)(A) and (D) permit a farmer to elect out of the capitalization rules for the first taxable year after December 31, 1986. If this election is made, expenses of raising otherwise covered plants and animals would generally be deductible to the same extent as under prior law.

This article focuses on the application of this new capitalization rule to expenses incurred by a cash basis farmer with respect to cattle to be used for breeding and dairy purposes, and with the consequences of electing to deduct such expenses.

Preproductive period

In the case of an animal that will have more than one yield, the preproductive period is the period before the first marketable yield from that animal. IRC § 263A(e)(3)(A)(i). In the case of a cow to be used for breeding or dairy purposes, the preproductive period would begin at the later of the time the animal was conceived, its embryo was implanted in its surrogate mother, or it was acquired by the farmer. The preproductive period would not end until the animal drops its first calf. *General Explanation of the Tax Reform Act of 1986*, page 513, prepared by the Staff of the Joint Committee on Taxation; Temp. Reg. § 1.263A-1T(c) (4)(ii)(C).

In the case of an animal that will not have more than one yield, the preproductive period is the period before such animal is reasonably expected to be disposed of IRC § 263A(e) (3)(A)(ii). However, the capitalization rule does not apply to "animals produced in a farming business if such animals are held primarily for slaughter" regardless of the length of the preproductive period and regardless of whether the taxpayer will slaughter the animal or will instead sell it to others for slaughter. Temp. Reg. § 1.263A-1T(c)(1).

section 263A, therefore, most cattle raised by a farmer to be held for breeding or dairy purposes by that farmer will have a preproductive period of more than two years. All direct and indirect expenses incurred with respect to such an animal during its preproductive period will have to be capitalized unless the farmer makes the election to deduct them.

Manner of election

The election will be *deemed* made if the farmer simply deducts the expenses that would be required to be capitalized if the election were not made. Temp. Reg. § 1.263A-1T(c) (6)(iv). Once made, the election will apply to the first year for which the election is made and future years unless revoked with the consent of the IRS. IRC § 263A(d)(3)(D).

Since the election can first be made for 1987, the manner in which a farmer treats covered expenses on the 1987 tax return will thus mandate the treatment of similar expenses for years to come. This is an election of an accounting method and therefore permission of the Commissioner is required to make a further change.

General consideration in making election

Most farmers are likely to be inclined to make the election to deduct covered costs for two major reasons: (1) they will assume the capitalization requirement would impose greater recordkeeping burdens; and (2) they will assume that electing to deduct the expenses provides greater tax benefits. Some farmers may make the election inadvertently by simply continuing to deduct the expenses as they have in the past.

The election to deduct expenses may in fact be the most sensible route for a particular farmer to take, but the consequences of making the election should be carefully considered before the decision is made.

Consequences of the election – generally

Three major direct consequences flow from the election: (1) expenses with respect to covered animals would generally remain deductible to the same extent as under prior law; (2) covered animals would be treated as section 1245 property, and gain on disposition will be "recaptured" as ordinary income to the extent of deductions taken with respect to the animals which would have been capitalized but for the election; IRC § 263A(e)(1); (3) if the election is made by the farmer or any "related person," all depreciable property placed in service by the farmer or related person during any taxable year during which the election is in effect and used "predominantly in the farming business" must use the alternative method of depreciation described in IRC section 168(g)(2). IRC § 263A(e)(2).

Recordkeeping requirements

If the election is not made, both direct and indirect expenses attributable to covered animals will have to be capitalized until the productive

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stage is reached. Direct costs would include direct labor and feed costs. Temp. Reg. § 1.263A-1T(b)(2)(i). Indirect costs could include a portion of utility costs, rental costs, depreciation, insurance, and so on. Temp. Reg. § 1.263A-1T(b)(2)(iii). Since the preproductive period can begin at conception, there may be an overlapping of productive and preproductive periods. For example, expenses, including depreciation, attributable to a breeding cow that has already reached its productive period may have to be capitalized in whole or in part each time it conceives, from the time of conception until birth, or perhaps even until weaning, if the calf will have a preproductive period of more than two years and thus be subject to a separate capitalization requirement. The deduction under section 179 may also be effectively unavailable with respect to a cow whose first calf is subject to its own capitalization requirement.

Depreciation of a covered animal could not begin until the productive stage is reached, at first calving. A different rule may exist as to breeding cattle purchased within two years of first calving, and which would thus not be covered by the capitalization requirement, since under prior law breeding cattle were considered placed in service for depreciation purposes when they were *ready* to be bred. *Farmer's Tax Guide*, page 28, IRS Pub. No. 225 (1986 ed.).

The need to trace actual direct and indirect costs to a particular animal could obviously impose substantial recordkeeping burdens. It is with the hope of avoiding these burdens that many farmers will elect to deduct such costs. However, a farmer may not need to keep track of actual costs. The temporary regulations provide that a method similar to the farm-price or unit-livestock-price method for valuing inventory may be used with respect to breeding and dairy animals even though these animals are not inventory property. Temp. Reg. § 1.263A-1T(c)(5)(iii). These methods could be used for this purpose by an accrual basis farmer who keeps inventories but does not include breeding and dairy animals in such inventories. These methods could presumably also be used for this purpose by a cash basis farmer who does not keep inventories at all. Under the unit-livestock method, for example, the farmer would classify livestock according to kind and age and assign a standard unit price, based on expected production costs, to all covered animals in each class. See Treas. Reg. § 1.471-6(e). Although difficulties may be encountered in the use of either of these alternative methods, farmers who capitalize expenses will likely use one of them in lieu of attempting to trace actual costs.

Unfortunately, farmers electing to deduct covered costs may not find their recordkeeping requirements substantially different than if such costs had been capitalized. Under prior law, if raised breeding or dairy cattle were sold, the farmer would normally have no basis in the animals, all costs having been deducted, and gain could often be reported in full as capital gains. See IRC § 1231(a), (b)(3). However, under IRC section 263A(e)(1), gain must be recaptured as ordinary income to the extent of the deductions taken which would have been capitalized but for the election. These deducted costs will probably be accounted for in the same manner as if they were capitalized, since the farmer is allowed to estimate such costs for recapture purposes by using the farm-price or unit-livestock methods. Temp. Reg. § 1.263A-1T(c)(6)(vi)(A). Thus, the recordkeeping burdens with respect to a particular animal which will eventually be sold may be similar whether the farmer capitalizes or elects to deduct covered expenses.

However, an electing farmer could presumably avoid the need to determine the amount of covered expenses deducted if the farmer is willing to report *all* gain on disposition as recaptured ordinary income. The distinction between the tax treatment of capital gains and ordinary income was substantially eliminated under the new law, but some differences will still exist. The maximum tax rate is higher for ordinary income than capital gains for 1987. IRC § 1(j). Capital losses will still be deductible only to the extent of capital gains plus $3,000. IRC § 1211(b). Additionally, all gain recaptured as ordinary income would have to be reported in the year of sale even if all payments have not been received. IRC § 453(i).

No accelerated depreciation if election made

If the election is made to deduct covered costs, the perceived tax benefits of such deductions will have to be compared with what could possibly be a very significant tax cost. If the election is made by the farmer or "any related person," only alternative depreciation described in IRC section 168(g)(2) will be available with respect to any depreciable property used predominantly in *any* farming business of the farmer or related person and placed in service while the election is still in effect. IRC § 263A(e)(2)(A); Temp. Reg. § 1.263A-1T(c)(6)(vi)(B). However, the deduction under IRC section 179 would still be available to the extent permitted in that section. Temp. Reg. § 1.263A-1T(c)(6)(vi)(B).

A "related person" for this purpose includes the farmer and his or her spouse and children who have not reached the age of eighteen as of the last day of the taxable year in question. IRC § 263A(e)(2)(B), (C). It also includes any corporation if fifty percent or more of the stock (in value) is owned directly or indirectly by the farmer or member of the farmer's family; a corporation and any other corporation which is a member of the same controlled group within the meaning of IRC section 1563(a)(1); and any partnership if fifty percent

(continued on next page)

or more in value of the interests in such partnership are owned directly or indirectly by the farmer or members of the farmer's family. IRC § 263A(e)(2)(B).

Alternative depreciation under IRC section 168(g)(2) is limited to straight line depreciation over longer periods than available under the accelerated methods described in IRC section 168(b). Once the election is made, alternative depreciation is mandated for depreciable property placed in service during the year to which the election relates and thereafter in *any* farming business of the farmer or related person. Temp. Reg. § 1.263A-1T(c)(6)(vi)(B). For example, the election may be made with respect to dairy and breeding cattle by a farmer who also grows grain for market. In that situation, all depreciable property placed in service in *both* the livestock and grain-growing activities while the election is in effect would have to use alternative depreciation. Temp. Reg. § 1.263A-1T(c)(6)(vii), Example(1). A worst case scenario would involve a farmer with only a few dairy cattle and a major crop operation involving very expensive machinery and equipment who elects to deduct the costs of raising the cattle. However, even in less egregious circumstances, the loss of accelerated depreciation with respect to other depreciable property used by the farmer would have to be weighed against the benefits of currently deducting the costs of raising the breeding and dairy cattle.

Conclusion

Two key points need to be reemphasized. First, electing to deduct costs otherwise required to be capitalized by new IRC section 263A will *not* leave a farmer in the same position as under prior law. The election brings with it consequences that need to be evaluated before the election is made. Second, for those currently farming, a decision must be made for 1987, with respect to covered expenses, which will be binding in this and subsequent years.

Milk order areas

The Third Circuit has upheld a district court's order that enjoined the Secretary of Agriculture from implementing amendments to the Middle Atlantic and New York – New Jersey Milk Marketing Orders. *LeHigh Valley Farmers v. Block*, 829 F.2d 409 (3rd Cir. Sept. 15, 1987).

The Secretary had sought to add twenty counties to two milk marketing areas. The district court found that this decision was not supported by substantial evidence in the record. The circuit court agreed as the absence of substantial evidence meant there was no rational basis for altering the established marketing orders.

– Terence J. Centner

Federal Register in brief

The following is a selection of matters that have appeared in the *Federal Register* in the last few weeks.

1. FCIC; General Crop Insurance Regulations; Interim Rule. Effective date Sept. 29, 1987. "Redefin[es] the insurance period for all insured crops to provide that insurance attaches on the later of when the crop is planted or when the application is properly completed, signed, and delivered to the service office in addition to the other attachment references therein." 52 Fed. Reg. 36400.
2. EPA; Notification to Secretary of Agriculture of a Final Regulation on Pesticide Registration Procedures and Pesticide Data Requirements. Dated Sept. 21, 1987. 52 Fed. Reg. 36595.
3. PSA; Certification of Central Filing System; New Hampshire. 52 Fed. Reg. 37192.
4. PSA; Certification of Central Filing System; South Dakota. 52 Fed. Reg. 37192.
5. ASCS; Grain Warehouses; Definitions, Financial Requirements and Warehouse Bonds; Final Rule. Effective date: Jan. 1, 1988. 52 Fed. Reg. 37125.
6. CCC; Loans, Purchases, and Other Operations; Determination of Interest Rates; Proposed Rule. 52 Fed. Reg. 37160.
7. CCC; Standards for Approval of Warehouses for Grain, Rice, Dry Edible Beans, and Seed; Proposed Rule. 52 Fed. Reg. 37619.
8. FCA; Farm Credit System Regulatory Accounting Practices; Temporary Regulations; Final Rule with request for comments. 52 Fed. Reg. 37131.
9. USDA; National Agricultural Statistics Service; Cattle Grazing Rates on Privately Owned Nonirrigated Land. 52 Fed. Reg. 37351.
10. USDA; Resource Conservation and Development Program; Determination of Primary Purpose of Program Payments and Benefits for Consideration as Excludable From Income; Notice of Determination. "The Secretary has determined that certain payments . . . under . . . the Program . . . are made primarily for the purpose of conserving soil, protecting or restoring the environment, or providing a habitat for wildlife. . . ." 52 Fed. Reg. 38805.
11. Dept. of Justice; IRCA; Unfair Immigration-Related Employment Practices; Final Rule. Effective date: Nov. 5, 1987. 52 Fed. Reg. 37402.
12. BLM; Grazing Administration – Exclusive of Alaska; Grazing Fees; Proposed Rulemaking. Comments due Nov. 23, 1987. 52 Fed. Reg. 37485.
13. IRS; Statement of Procedural Rules; Amendment. Effective date: Oct. 16, 1987. Relates to "written protest procedures to obtain appeals consideration of the findings of field examinations." 52 Fed. Reg. 38405.
14. Administrative Conference of the United States; The Discretionary Function Exception to the Federal Tort Claims Act; Notice of Inquiry. 52 Fed. Reg. 39672.

– Linda Grim McCormick

AG LAW CONFERENCE CALENDAR

Ninth Annual AALA Conference.
Oct. 13-14, 1988 Crown Westin Center, Kansas City, MO
Annual meeting and educational conference of the American Agricultural Law Association
Watch this column for details. Mark your calendar now.

Penn State Income Tax Institutes – 1987.
Dec. 2-3, Holiday Inn, Uniontown, PA
Dec. 2-3, Quality Inn, Johnstown, PA
Dec. 2-3, Family Heritage Restaurant, Souderton, PA
Dec. 7-8, Keller Conference Center, State College, PA
Dec. 14-15, Best Western Conley Inn, Monroeville, PA
Dec. 14-15, Holiday Inn, Edinboro, PA
Dec. 14-15, Holiday Inn, Harrisburg, PA
Dec. 16-17, Holiday Inn, Beaver Falls, PA
Dec. 16-17, Holiday Inn, Dubois, PA
Dec. 16-17, Holiday Inn, Hazelton, PA

Topics include: Issues affecting tax shelters; capitalization and preproductive costs; and crucial issues in filing rural returns.

Sponsored by The Pennsylvania State University Department of Agricultural Economics Farm Management Extension.

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STATE ROUNDUP

FLORIDA. *Current use dictates agricultural tax classification.* In *Roden v Estech, Inc.*, 508 So.2d 728 (Fla. App. 2 Dist 1987) the Florida Second District Court of Appeals considered, among other issues, agricultural tax valuation of land previously classified as agricultural property but whose future use appeared to be non-agricultural.

In 1982, the court of appeals had affirmed without opinion a trial court holding that certain lands owned by Estech, Inc., were entitled to agricultural classification for tax assessment purposes. In 1983, the county property appraiser determined that the classification was no longer valid because Estech had promulgated a conceptual mine plan for the property. Estech had not, however, received a mining permit.

The trial court held that Estech was entitled to the agricultural classification as to this property. The county property appraiser, tax collector, and State Department of Revenue appealed the agricultural classification.

The court of appeals held that the previously agriculturally classified property still merited such classification. Estech had not yet received a mining permit. The court held that once it had found a good faith agricultural use of the property, that property's future use is irrelevant. The current use of the property controls its classification. Also, the court held that Estech's use of adjoining properties for mining did not affect the proper classification of the agricultural property.

— *Sid Ansbacher*

IOWA. *Voidable landlord's lien.* The case of *In re Waldo*, 70 Bankr. 16 (Bankr. N.D. Iowa 1986), vividly demonstrates the wisdom of perfecting an Article Nine security interest in a landlord's claim for rent under a lease. The court allowed the trustee to avoid the landlord's claim of a statutory lien for rent. In addition, the court ruled that the landlord's claimed contractual lien for rent based on language in the written lease was also avoidable by the trustee as being inferior to the trustee's interest as a hypothetical lien creditor.

The trustee relied on section 545(3) of the Bankruptcy Code, which provides that a trustee may avoid a statutory lien on the debtor's property to the extent the lien is for rent. The court said the effect of section 545(3) "is to wholly invalidate a statutory lien created by the Iowa Code. Thus, if [the landlord's] lien is regarded as a statutory lien then it is voidable by the trustee.

Since the statutory lien was found to be voidable, the next question was whether an unrecorded contractual lien for rent was also voidable. Pre-UCC law in Iowa required recordation of chattel mortgages in order to be effective against existing creditors and subsequent purchasers. Iowa Code § 556.3. (Case law equated contractual liens with chattel mortgages.) With passage of the UCC in Iowa, Iowa Code section 556.3 was repealed. UCC section 9-104(b) states Article Nine does not apply to landlord's liens. While the Iowa Supreme Court has not addressed the issue, the bankruptcy court recognized that several other states have held that "the U.C.C. section 9-104(b) exlusion applies only to landlord's liens arising by statute and has no applicability to those landlord liens arising by contract." 70 Bankr. at 19 (citing *Todsen v. Runge*, 211 Neb. 226, 318 N.W.2d 88 (1982)).

The court concluded that it "believes that the Iowa Supreme Court would follow *Todsen* and the numerous other cases which take the position that liens arising from contract must comply with the filing requirements of Article 9 for perfection." 70 Bankr. at 19

In perhaps the most interesting aspect of the opinion, the court intimated that a landlord claiming on the basis of a contractual landlord's lien would have an inferior interest to any creditor establishing a perfected security interest prior to the landlord's perfection of the contractual lien, which would include the trustee here, who is given the status of a hypothetical lien creditor under section 544 of the Bankruptcy Code. For example, the court noted "[i]n the present situation a creditor on December 16, 1985, would find the [landlord's] contractual landlord's lien unperfected and her security interest thereby inferior to that of any lien creditor." *Id.* What is unclear from the court's opinion is whether it is also concluding that the landlord's statutory lien for rent under Chapter 570 (as opposed to a contractual lien under the lease terms) would be inferior to any lien creditor.

— *Neil D. Hamilton*

OKLAHOMA. *Security interests and embryo transfers* D&B Brangus, debtor, obtained financing for its ranching operation from FmHA and Fairview State Bank. In its collateral description, FmHA took a security interest in "[a]ll livestock . . . now owned or hereafter acquired . . . together with all increases, replacements, substitutions, and additions thereto. . . ." Fairview State Bank took a security interest in Brangus cows including "all additions and replacements to the property, along with all proceeds" and "after-acquired property."

D&B Brangus subsequently contracted with Granada Land & Cattle Company whereby selected D&B cows were inseminated by semen from Granada bulls. The fertilized eggs were flushed from the donor cows a week after conception. The calf embryos were then transferred to recipient cows owned by Granada. Once the recipient cows were confirmed to be pregnant at sixty days, Granada paid D&B $500 for each calf embryo.

D&B filed for bankruptcy and claimed that neither FmHA nor Fairview State Bank had a security interest in the calf embryos or the proceeds from their sale because at the time that the financing was obtained, none of the parties contemplated an embryo transfer program.

On a certified question to the Supreme Court of Oklahoma from the Bankruptcy Court for the Western District of Oklahoma, the supreme court ruled that the collateral descriptions were sufficient to give FmHA and Fairview State Bank perfected security interests in the calf embryos and the proceeds from the sale of those embryos. *Fairview State Bank v. Edwards*, 739 P.2d 994 (Okla. 1987).

The supreme court held that calf embryos are unborn young of livestock, which is a type of goods under the Code. Hence, D&B as debtor had rights in the embryos as unborn young which could be used as collateral. The supreme court also held that calf embryos were included within the description of the collateral in which a security interest had been granted through the terms "increases," "additions," and "replacements" of the livestock or cows about which no dispute existed that a security interest had been granted by D&B to FmHA and Fairview State Bank.

Finally, the supreme court ruled that to hold that calf embryos were not "increases" of cattle would allow D&B, or any rancher, to avoid a security interest in after-acquired calves by simply changing the rancher's method of operation from the production of live calves to the selling of calf embryos. As a matter of policy, the supreme court did not believe that debtors should be encouraged to try to avoid perfected security interests by changing methods of operation.

— *Drew L. Kershen*

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Professor John Becker, Department of Agricultural Economics, Penn State University, University Park, PA 16802 is in charge of the 1988 Writing Competition Inquiries about the competition should be directed to him